

Good afternoon. On behalf of Chairman Mark David Goss and Commissioner Greg Coker, greeting from the Kentucky Public Service Commission and best wishes for the new year. As someone who grew up in Whitley County and graduated from Morehead State, I can assure you that it is always a pleasure for me to return to those portions of our Commonwealth that are east of I-75.

Thank you for the opportunity to speak with you today. Before I came to work in state government, Frankfort often seemed to me to be a foreboding and mysterious place, cloaked in an impenetrable bureaucratic fog. Now that I've been there for a couple of years, I can tell you there are many days when it still seems that way. But I also have gained a much greater appreciation of the enormous role that state government plays in the lives of our citizens and of the responsibility that those in government have to carry out their duties for the benefit of all Kentuckians.

So I am very please to be here today to try to cut through some of that fog and tell you a little bit about the Kentucky Public Service Commission, and specifically our role in an area that I know is very much on everyone's mind – the high cost of natural gas.

The PSC was established by the Kentucky General Assembly in 1934. It is an independent, quasi-judicial regulatory agency, with three commissioners appointed by the governor and confirmed by the Senate to serve four-year terms.

The Commissioners are assisted by a 110-person staff comprised mostly of accountants, engineers, attorneys and other professionals.

Over the years, the PSC's jurisdiction has changed somewhat – we no longer regulate streetcar companies, for example. Today, the PSC has under its jurisdiction a total of about 1,500 utilities, including investor-owned electric, gas, water and sewer companies, electric and telephone cooperatives, water districts and associations, and a wide variety of telecommunication companies. There is hardly a citizen in the Commonwealth whose life is not affected in some manner by decisions made at the PSC.

In the spring of 2003, when the Kentucky Public Service Commission first became concerned about the rising cost of natural gas, we initiated a communication effort that involved all of the state's major natural gas distribution companies, including Delta Natural Gas, as well as several other state agencies. Our goal was to educate consumers, and particularly the news media, about the workings of the natural gas market, the state's role in regulating the industry and especially what consumers can do to manage their heating costs. That effort has continued over the last two winters. But it wasn't until this past fall that we really attracted the attention of the public and the news media.

After hurricanes Katrina and Rita tore through the oil and natural gas fields along the Gulf Coast, all of us read or heard frightening predictions about how much more it will cost to heat our homes this winter. We saw the estimates – 40

percent more, 50 percent more, even 60 percent more than last year – and that's assuming the weather would be no colder than the mild winters we've had recently. Unfortunately, those frightening forecasts have proven to be correct.

Kentuckians who heat their homes or businesses with natural gas, propane or fuel oil – about 57 percent of our citizens - are experiencing substantially higher energy costs this winter. The 40 percent of Kentuckians who heat with electricity also are seeing increases, though they are modest by comparison.

While the hurricane damage to one of our nation's major energy-producing regions is partly responsible for these increases, the fact is that Katrina and Rita simply amplified a problem that has been with us for the last two years. Even without the hurricanes, natural gas prices in particular would have been significantly higher this winter.

What I would like to do today is to tell you how we got to this point, explain state government's role in regulating energy prices, and, offer some suggestions for what consumers can do to take control of their own energy costs. I'm going to focus on natural gas, because that is the fuel that 44 percent of Kentuckians use to heat their homes and because it is the greatest cause for concern.

High natural gas prices did not get here overnight. Their roots lie in policy decisions made decades ago in response to the energy crises of the 1970s. One

of the effects of those crises was higher demand for natural gas as a substitute for fuel oil. At the time, the federal government controlled the price of natural gas at the wellhead. With prices capped, there was little incentive for producers to seek out and develop new sources of natural gas.

Recognizing that, Congress in 1978 took the first steps toward deregulating the wholesale price of natural gas. Deregulation was completed in 1993, and natural gas became a commodity – just like soybeans or pork bellies - whose price would be driven entirely by the supply and demand forces present in the national marketplace.

While deregulation achieved its goal of increasing the supply of natural gas, other factors were driving up demand. Chief among these were local, state and federal air-quality regulations that encouraged the use of clean-burning natural gas to power electric generating plants, particularly in the Northeast and California, where air pollution problems are the most severe.

Even with deregulation, natural gas prices remained relatively stable as long as supply and demand stayed in balance. Prices spiked during the winter of 2000-2001, but quickly returned to lower levels.

The situation began to change in the spring of 2003. With economic recovery in full swing, supply began having trouble keeping up with demand. Instead of

dropping sharply during the summer – as they had always done in the past – natural gas prices remained at near-winter levels as demand stayed high. That meant that the utilities that deliver gas to consumers were paying more for the gas they stored for delivery during the heating season.

In the winter of 2003-2004, the wholesale price of natural gas was 25 to 40 percent higher than it had been a year earlier. Wholesale prices went up another 10 to 20 percent last winter. Fortunately for Kentucky consumers, the last two winters have been relatively mild, so the full impact of those price increases has not been felt in our state.

The natural gas market took a turn for the worse this summer. Much of the nation experienced very hot weather, which increased demand for natural gas in order to generate electricity to keep air conditioners running. By August, wholesale prices had nearly doubled from a year earlier.

Then came Katrina and Rita. Natural gas production came to a standstill on the Gulf Coast, which produces about a fourth of our nation's natural gas, and most of the gas used in Kentucky. Today – about five months after Katrina and more than four months after Rita – nearly one-fifth of that production remains off line. Annual production this year from the Gulf Coast was down by about 16 percent in 2005.

The marketplace reacted in predictable fashion by driving natural gas prices to record levels. Since then, prices have gyrated wildly in response to the weather – most recently taking a dive during an extended warm spell over much of the nation. Prices for the remainder of this heating season will be determined mostly by demand – how cold a winter do we have – and also by supply – how long it takes to restore full production from the Gulf Coast.

In the past weeks, the PSC has heard from many consumers who want to know what, if anything, their state government can do to control the cost of natural gas. The state's power is limited, because the state regulates only a relatively small portion of the total price a consumer pays. The wholesale cost of natural gas makes up 80 percent or more of the typical consumer's bill during the heating season. And any renewed controls on wholesale natural gas prices would have to come from the federal level.

Where the Kentucky PSC does have regulatory authority, I can assure you that it is being exercised:

- Natural gas distribution companies are entitled to pass along their wholesale costs to consumers. Those cost calculations must be submitted for review to the PSC, which reviews them thoroughly to ensure that they are accurate and reasonable.
- Natural gas distribution companies such as Atmos Energy are not allowed to earn any profit whatsoever on their wholesale costs. Again, the PSC

scrutinizes the costs to ensure that they are passed along to consumers on a dollar-for-dollar basis only.

- The portion of a consumer's gas bill that is not the commodity cost of natural gas represent a distribution company's costs – operating and maintaining its system, providing customer service, purchasing equipment, paying wages and benefits to its employees. This base rate is set by Public Service Commission only after an exhaustive review, and is the only portion of the total rate that includes a profit for the company.

One other important thing to remember about profits: A distribution company's profit margin represents only a small fraction of a customer's heating bill. With wholesale costs as high as they are, eliminating that profit entirely would have a negligible effect on the total gas rate. So it is simply not the case that these high gas bills represent a windfall for the companies that operate local gas distribution systems in Kentucky. State regulation does not allow it.

Even though we are at the mercy of the forces driving the national market for natural gas, there are things we can do in Kentucky to deal with these high heating costs.

The most important thing to remember is that we each control our own energy consumption. There are steps every consumer can take to reduce their heating bills by reducing the amount of natural gas, propane or electricity they consume:

- Begin by simply turning down the thermostat. For every degree you reduce the setting below 75, you reduce energy consumption by 2 or 3 percent.
- Make sure your home is weatherized. That means caulking around windows and doors, replacing worn weatherstripping, adding insulation if possible, and using storm windows or plastic over single-pane windows. Anything that keeps cold air out and warm air in will reduce your heating bill.
- Make sure that your heating and ventilation systems are in good working order. If necessary, have them checked by a professional.

Many utilities in Kentucky offer home energy audits at little or no cost. They are a good way to identify steps you can take to save energy.

While high heating costs will affect everyone, we all recognize that they fall disproportionately on those in our state who live on limited or fixed incomes. That is why there are a number of programs to assist those who are going to be most affected by high energy costs.

The Low Income Home Energy Assistance Program, or LIHEAP, helps with energy bills. It is administered by local community action agencies. Residents should contact their local agency for information. In addition, many utilities offer assistance programs, and help may be available from other sources in the

community, such as social service agencies, faith-based organizations and others. Weatherization assistance also is available for those in need.

Information about energy efficiency, weatherization and home energy assistance programs is available on the state government Web site, Kentucky-dot-gov.

Whether a consumer needs assistance with energy costs or not, there is one valuable tool that can help all utility customers with their home heating bills. It is known as a budget billing or even-payment plan. It spreads your total utility bill over a 12-month period. While it does not reduce high energy costs, a budget billing plan makes it easier to cope with them by smoothing out seasonal fluctuations and providing a predictable bill every month. It's an option everyone should consider.

Finally, there is one aspect of this issue that causes great concern. Every year, we see or read stories about the deadly consequences of trying to heat or light homes by improvised means. These tragedies are needless and entirely preventable.

If you know anyone who you believe might need assistance with energy costs this winter, encourage them to take steps immediately to make the necessary arrangements and not wait until they are in desperate straights.

There are ways we all can help our fellow citizens who may be less fortunate than we are. Make a donation to an energy assistance program. Participate in an effort to weatherize the homes of those in your community who cannot do so themselves. Spread the word about energy conservation and budget billing.

There is no doubt that the high cost of energy could make this a challenging winter for many in Kentucky. The PSC will continue to monitor the situation closely and to provide the citizens of the Commonwealth with information, and to take whatever steps we can to help Kentuckians deal with these difficult circumstances.